

Message Text

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INFO AMCONSUL RIO DE JANEIRO

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SUBJECT: GOVERNMENT ANNOUNCES MEASURES TO STRENGTHEN CAPITAL
MARKET

1. SUMMARY: THE GOB HAS ANNOUNCED A PACKAGE OF MEASURES
DESIGNED TO STRENGTHEN THE CAPITAL MARKET, TAKING A GLOBAL
RATHER THAN THE AD HOC APPROACH OF PREVIOUS ACTIONS. FOR THE
FIRST TIME, PRIVATE SECURITIES ARE PLACED ON AN EQUAL FOOTING
WITH GOVERNMENT SECURITIES. FISCAL INCENTIVES ARE
BEING PROVIDED THROUGH A SYSTEM OF TAX CREDITS AS OPPOSED
TO ONE OF DEDUCTIONS FROM GROSS INCOMES. THROUGH THESE
CHANGES, THE GOB HOPES TO INCREASE TOTAL NATIONAL SAVINGS
AND PERHAPS HAVE SOME FAVORABLE IMPACT ON INCOME DISTRIBUTION.
GOVERNMENT TAX REVENUES ARE ESTIMATED TO INCREASE BY ABOUT
8 PERCENT, MAINLY AS A RESULT OF A RISE IN CORPORATE INCOME
TAXES. END SUMMARY.

2. IN WHAT IS CONSIDERED THE MOST COMPREHENSIVE AND
COORDINATED APPROACH EVER TOWARD IMPROVING BRAZIL'S CAPITAL
MARKET, GOB ISSUED ON JULY 23 A DECREE LAW (NO. 1338)

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INTRODUCING FISCAL INCENTIVES DESIGNED TO STIMULATE

THE PURCHASE OF STOCKS AND BONDS. AT SAME TIME, FOLLOWING DECISIONS ADOPTED BY THE NATIONAL MONETARY COUNCIL, THE CENTRAL BANK OF BRAZIL ISSUED SIX RESOLUTIONS WHICH ARE RELATED DIRECTLY TO THE IMPLEMENTATION OF THE DECREE LAW AND TO INCREASING THE FLOW OF FUNDS INTO THE COMMERCIAL BANKING SYSTEM TO FINANCE SMALL AND MEDIUM SIZED FIRMS AND TO FINANCE FURTHER EXPANSION OF EXPORTS OF MANUFACTURES.

3. THE PRINCIPAL POINTS OF DECREE-LAW 1338 ARE AS FOLLOWS:

A. IT CHANGES THE SYSTEM OF FISCAL INCENTIVES FROM ONE BASED ON DEDUCTIONS FROM GROSS INCOME TO ONE BASED ON DIRECT TAX CREDIT. THIS WAS THE MOST FUNDAMENTAL CHANGE AND THE ONE POTENTIALLY THE MOST SIGNIFICANT.

B. IT INCREASED THE NUMBER OF SECURITIES WHOSE PURCHASE GIVE RISE TO A TAX CREDIT. IN ADDITION TO THE USUAL GOVERNMENT SECURITIES, THE ELIGIBLE SECURITIES NOW INCLUDE LETRAS DE CAMBIO, TIME DEPOSITS OVER TWO YEARS (WITH AND WITHOUT CERTIFICATES), MORTGAGE BONDS, DEBENTURES, STOCKS OF OPEN COMPANIES, STOCKS OF COMPANIES INVOLVED IN THE DEVELOPMENT OF NORTHEAST AND AMAZONIA, STOCKS OF COMPANIES FOR TOURIST DEVELOPMENT, SAVINGS ACCOUNTS IN THE NATIONAL HOUSING SYSTEM, STOCKS OF INVESTMENT BANKS AND INVESTMENTS IN FORESTRY OR REFORESTATION PROJECTS.

C. KEEPING IN LINE WITH THE CONCEPT OF PROGRESSIVITY OF INCOME TAXES, DECREE LAW ALLOWS TAX CREDIT OF UP TO 60 PERCENT OF TOTAL INVESTMENTS FOR LOWEST INCOME BRACKET (UP TO CR\$57,000 ANNUAL GROSS INCOME) AND TAX CREDIT OF ONLY 30 PERCENT FOR HIGHEST INCOME BRACKET (CR\$301,600 ANNUAL GROSS INCOME AND OVER). TOTAL TAX CREDIT IS APPLIED AGAINST INCOME TAX LIABILITY. EACH CLASS OF ELIGIBLE SECURITY HAS A SPECIFIED TAX CREDIT RATE, DEPENDING ON ITS ESTIMATED IMPORTANCE FOR THE ACHIEVEMENT OF GOB'S ECONOMIC OBJECTIVES. THE RATES RANGE FROM 2 PERCENT ON SAVINGS ACCOUNTS OF OVER CR\$36,000 (6 PERCENT FOR ACCOUNTS BELOW THIS CEILING), 3 PERCENT ON TREASURY BONDS (ORTN), 4 PERCENT ON LETRAS DE CAMBIO, 5 PERCENT ON REGULAR DEBENTURES, 12 PERCENT ON STOCKS OF OPEN COMPANIES, 20 PERCENT ON STOCKS OF TOURIST-RELATED FIRMS, AND 42 PERCENT ON STOCKS OF COMPANIES INVOLVED IN THE DEVELOPMENT OF THE NORTHEAST AND LIMITED OFFICIAL USE

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AMAZONIA.

D. THE NATIONAL MONETARY COUNCIL IS EMPOWERED BY THE DECREE LAW TO SET PERIODICALLY THE TERMS AND CONDITIONS OF THE ABOVE-STATED TAX CREDITS.

E. THE RATES APPLICABLE TO THE PORTION OF INCOME TAX PAYMENTS WHICH ARE USED TO BUY CERTIFICATES IN THE SO-CALLED FISCAL FUNDS 157 HAVE BEEN CHANGED IN FAVOR OF MIDDLE AND LOWER INCOME CLASSES, WHILE THE RECOUPMENT PERIOD FOR

THESE FUNDS HAS BEEN INCREASED FROM 4 TO 5 YEARS. (FISCAL FUNDS 157 IS A SYSTEM OF FORCED SAVINGS. THE GOVERNMENT THROUGH THIS SYSTEM USES A CERTAIN PORTION OF PERSONAL INCOME TAX REVENUES AND INVESTS THEM IN CERTAIN PRIORITY SECTORS. THE TAXPAYER THEN RECEIVES THIS MONEY BACK DURING THE COURSE OF SEVERAL YEARS. THE NET EFFECT OF THIS SYSTEM IS TO LOWER THE INDIVIDUAL TAX BURDEN WHILE INCRASING THE AMOUNT OF NATIONAL SAVINGS.)

F. WITH RESPECT TO THE TAXATION OF JURIDICAL ENTITIES, THE DECREE HAS INCREASED THEIR TAX BASE BY REQUIRING THAT IN THEIR PROFIT CALCULATIONS THEY ADD THE MONETARY CORRECTION RECEIVED FROM FIXED INCOME SECURITIES WITH POST-FIXED MONETARY CORRECTION AND NOT JUST THE REAL RATE OF INTEREST AS HAS BEEN THE CASE HERETOFORE. THIS MEASURE WILL HAVE A PARTICULARLY HEAVY IMPACT ON FINANCE COMPANIES AND COMMERCIAL BANKS.

G. DECREE ALSO STIMULATES THE FORMATION OF HOLDING COMPANIES IN THAT INTRA-COMPANY DIVIDEND PAYMENTS WILL HENCEFORTH BE EXEMPTED FROM THE WITHHOLDING TAX.

H. THESE BENEFITS WILL GO INTO EFFECT IN 1975 WHEN THE 1974 INCOME TAX PAYMENTS WILL BE MADE.

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4. THE SIX RESOLUTIONS ISSUED BY THE CENTRAL BANK INCLUDE THE FOLLOWING ACTIONS:

A. RESOLUTION 291 SETS THE CRITERIA TO BE MET BY INVESTORS WHO WISH TO BENEFIT FROM THE TAX CREDIT ON STOCK PURCHASES. THESE REQUIREMENTS ARE THAT THE INVESTOR CANNOT HOLD MORE THAN 0.5 PERCENT (ONE-HALF PERCENT) OF THE OUTSTANDING STOCK OF A GIVEN COMPANY, THAT HE MUST HOLD THE STOCKS FOR TWO YEARS, AND THAT HIS TOTAL ANNUAL STOCK INVESTMENT CANNOT EXCEED CR\$500,000.

B. RESOLUTION 292 LOWERS TO 70 PERCENT FROM 75 PERCENT THE PROPORTION OF REVENUES WHICH FISCAL FUNDS 157 MUST INVEST IN STOCKS OR BONDS OF WHOLLY-OWNED DOMESTIC OPEN CAPITAL COMPANIES. THUS, IT INCREASES BY 5 PERCENT PORTION OF FUNDS WHICH CAN GO INTO FOREIGN-OWNED COMPANIES. RESOLUTION ALSO ELIMINATES THE FORMER REQUIREMENT OF 25 PERCENT FOR INVESTMENT IN SMALL AND MEDIUM SIZED COMPANIES.

C. RESOLUTION 293 INCREASES THE INTEREST RATE CEILINGS ON SAVINGS DEPOSITS AND LETRAS DE CAMBIO RECENTLY APPROVED UNDER RESOLUTION 286 (SEE BRASILIA 3419). IT INCREASES THE RANGE FROM 24-26 PERCENT TO 26-28 PERCENT. MAXIMUM INTEREST RATES ON BANK LOANS HAVE ALSO BEEN BOOSTED TO LIMITED OFFICIAL USE

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33-34 PERCENT. THE REASON FOR THESE INTEREST RATE CHANGES, ONLY THREE MONTHS AFTER THE LAST ONE, IS TO ADJUST FOR THE HIGH RATE OF INFLATION THIS YEAR.

D. RESOLUTION 294 DECREASES BY 3 PERCENTAGE POINTS WITHHOLDING TAX ON FIXED INCOME SECURITIES WITH PRE-FIXED MONETARY CORRECTION.

E. RESOLUTION 295 INCREASES TO 4 PERCENT FROM 2 PERCENT LEVEL OF COMPULSORY DEPOSITS OF COMMERCIAL BANKING SYSTEM WHICH MAY BE FREED FOR USE IN MAKING WORKING CAPITAL LOANS TO SMALL AND MEDIUM SIZED INDUSTRIAL AND COMMERICAL ENTERPRISES.

F. RESOLUTION 296 INCREASES THE BANKING SYSTEM RESOURCES FOR FINANCING EXPORTS OF MANUFACTURERS BY ABOUT CR\$150 MILLION.

COMMENT.

5. WITH THE INTRODUCTION OF THESE MEASURES, THE GOB FOR THE FIRST TIME HAS ADOPTED A GLOBAL APPROACH TOWARD STRENGTHENING THE CAPITAL MARKETS. UNLIKE THE PRVIOUS AD HOC MEASURES DESIGNED TO HAVE SOME IMMEDIATE IMPACT,THE LATEST CHANGES ARE TAILORED TO HAVE A LONGER TERM BENEFIT. THIS HAS BEEN BORNE OUT BY THE BEHAVIOR OF THE STOCK MARKET, WHICH HAS NOT MOVED UP IN ANY SIGNIFICANT WAY SINCE THE MEASURES WERE ANNOUNCED.

6. ANOTHER IMPORTANT ASPECT OF THESE MEASURES IS THAT THEY PROVIDE AN INCENTIVE FOR TRADING ON THE SECONDARY MARKETS.

PREVIOUS MEASURES HAD FOCUSED PRIMARILY ON THE PRIMARY MARKET, I.E. , THE ORIGINAL ISSUE AND PURCHASE OF SECURITIES. ALSO, THESE MEASURES PUT PRIVATELY ISSUED SECURITIES ON AN EQUAL FOOTING WITH GOVERNMENT SECURITIES, SUCH AS THE ORTN.

7. BY BASING THE FISCAL INCENTIVES ON A SYSTEM OF TAX CREDITS, THE GOB HOPES TO INCREASE TOTAL NATIONAL SAVINGS BY STIMULATING PERSONAL SAVINGS AT THE LOWER (MIDDLE-CLASS) INCOME BRACKETS. THE EXPECTATION IS THAT PEOPLE IN LOWER INCOME BRACKETS CAN NOW SEE A DIRECT RELATIONSHIP BETWEEN INVESTING AND DECREASING THEIR TAX LIABILITIES AND WILL THUS INVEST MORE. SINCE THE TAX CREDIT IS INVERSELY RELATED TO THE LEVEL OF INCOME, THE GOB ALSO SEES SOME POTENTIAL LIMITED OFFICIAL USE

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FOR IMPROVING INCOME DISTRIBUTION THROUGH THESE MEASURES.

8. WITH RESPECT TO THE IMPACT ON GOVERNMENT TAX REVENUES, AUTHORITIES ARE ESTIMATING AN 8 PERCENT INCREASE. HOWEVER, THEY EXPECT THESE ADDITIONAL REVENUES TO COME FROM CORPORATE INCOME TAXES, MAINLY AS A RESULT OF THE CHANGE IN THE HANDLING OF MONETARY CORRECTION IN INCOME STATEMENTS, RATHER THAN FROM INDIVIDUAL INCOME TAXES, WHERE THE IMPACT IS EXPECTED TO BE NEUTRAL. CRIMMINS

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